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IN THE

Supreme Court of the United States

OCTOBER TERM, 1972

No. 72-1490

FEDERAL POWER COMMISSION

v.

TEXACO, INC., ET AL.

No. 72-1491

DUDLEY T. DOUGHERTY, ET AL., CO-EXECUTORS OF THE ESTATE OF MRS. JAMES R. DOUGHERTY, ET AL.

v.

TEXACO, INC., ET AL.

On Petitions for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR THE PUBLIC SERVICE COMMISSION FOR THE STATE OF NEW YORK IN OPPOSITION

PRELIMINARY STATEMENT

The Public Service Commission for the State of New York (New York), the petitioner in one of the cases consolidated for briefing and argument below, files herewith its opposition to the petitions for certiorari in Numbers 72-1490 and 72-1491. The petitions seek plenary review of the Opinion and Order of the Court of Appeals for the District of Columbia Circuit (Pet. App.

1a-22a; 23a-25a)[1] setting aside certain orders of the Federal Power Commission prescribing a new method of "regulating" the price of sales by small producers of natural gas in interstate commerce for resale. New York is the regulatory body established by the State of New York to control, *inter alia*, the rates at which natural gas is distributed at retail in the state. As such it is directly interested in proceedings before the Federal Power Commission to fix the rates at which natural gas may be sold to the pipelines serving New York, and participated actively both in the proceedings before the Commission and in the court below.

QUESTION PRESENTED

Whether the Court of Appeals correctly determined that the Federal Power Commission has no authority to exempt small producers from all direct regulation of the rates in which they sell gas in interstate commerce for resale, and to limit the indirect regulation of such sales in the rate proceedings of pipeline and large producer purchasers to the possible disapproval of purchased gas costs resulting from contract prices in excess of both the *highest* rate at which any large producer contracted to sell gas in interstate commerce in the area or the prevailing contract rates of *unregulated* intrastate sales therein?

STATEMENT OF THE CASE

I. Background

Ever since *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672, questions have been raised as to the appropriate procedures for regulating the numerous small producers of natural gas who account for a relatively small

[1] "Pet. App." refers to the appendices to the Petition in Case No. 72-1490.

portion of the total volumes of gas, and purchased gas costs of the interstate pipelines. Since there are more than three thousand separate entitles engaged in natural gas production and sale for resale in interstate commerce, questions were presented as to how the Commission could manage its responsibilities, and equally important, how the administrative expenses of regulation could avoid imposing an unnecessary economic burden on the smaller producers. The problem was peculiarly acute during the eight-year period subsequent to *Phillips* when the Commission operated on the assumption that the proper manner of regulating producers was the individual company basis it had applied in the case of pipelines and electric utilities. The avoidance of the administrative morass consequent upon the holding of thousands of separate proceedings was one of the principal factors that led the Commission in the second *Phillips* case, 24 FPC 537 (1960), to move to area rates as the solution for its producer rate problems.

The Commission's determination to abandon individual producer rate cases was affirmed in *Wisconsin* v. *Federal Power Commission*, 373 U.S. 294. In his dissenting opinion there (373 U.S. at 329-330), Mr. Justice Clark first raised the question of a possible "temporary" exemption of small producers while the Commission concentrated on the rates of the largest individual producers. This, he suggested, might be a more effective approach to the administrative problem than the area rate technique. Subsequently, in *Federal Power Commission* v. *Hunt*, 376 U.S. 515, 527 (1964), Justice Clark, here speaking for a majority of the Court in a certificate case, suggested that the administrative delay resulting from dealing with all producer sales certificate applications on an individual basis, might be avoided if the Commission found itself in a position to utilize exemption practices similar to those then followed by the National Labor Relations Board.

In the *Permian Basin Area Rate Proceeding*, 34 FPC 159 (1965), the first of the area proceedings, the Commission came to grips with the problem of the small producers. The Commission concluded (34 FPC at 234-235) that special treatment for small producers which would ease the burdens of regulation without the risk of substantial impact on consumer prices would be in the public interest. But it also determined (*ibid.*) that an outright exemption of small producers, assuming it was legally permissible, was neither "necessary nor desirable." In reaching this determination, the Commission found that "the impact of small producer prices on consumers is by no means *de minimus* and is of great impact in some instances" (34 FPC at 235). The Commission also found that the penetration of the rate ceilings which would result from an absolute exemption of small producer sales from rate regulations could be "seriously disruptive of a pattern of uniform area rates" (*ibid.*).

While making the area just and reasonable rates applicable to all producers, small and large alike, the Commission in *Permian* initiated action, consummated by Order 308 issued on November 5, 1965, (*Rate and Certificate Filings by Small Independent Producers*, 34 FPC 1202), to relieve small producers of virtually all of the administrative burdens and costs of both the rate and certificate provisions of the Natural Gas Act. This action took the form of the establishment of "Small Producer Certificates" available to any producer with jurisdictional sales of less than 10,000,000 Mcf of gas per year, under which the producer would be able to make all of its existing sales, and any new ones, without seeking further authorization from the Commission as long as his total annual sales did not exceed the prescribed maximum, and the price therefor did not exceed the applicable just and reasonable ceilings for such gas in the particular area.

In addition, the Commission in its *Permian* decision gave small producers the option of being relieved from the rate adjustments it imposed on large producers with respect to abnormal gas quality conditions (see 34 FPC at 225). This exception to the general area rate structure was justified by the Commission on grounds of its *de minimus* effect on the overall gas costs and the fact that the costs of determining the necessary quality adjustments for the many small producers would be greater than the total amount of the adjustment.

In its decision affirming the Commission's Permian Basin opinions, this Court expressly affirmed the Commission's treatment of small producers. Specifically, it found that the Commission had a proper factual basis in the record for classifying small producers separately, and that the "carefully selected special arrangements for small producers" which the Commission had found "would not improperly increase consumer prices" were "fully consistent with the terms and purposes of [the Commission's] statutory responsibilities." *Permian Basin Area Rate Cases*, 390 U.S. 747, 787 (1968). The Court's opinion, of course, does not hold that the Commission's power to classify small producers for special regulatory treatment authorized it to exempt them from all effective rate regulation; the Commission had rejected this approach and it was not advocated by any party in the Supreme Court review of the Commission's decision.

II. The Present Proceeding

The instant case was instituted by a Notice of Proposed Rule Making (R. 1) issued by the Commission in Docket No. R-393 on July 23, 1970. In this Notice the Commission proposed simply to exempt most small producers from all provisions of the Natural Gas Act and the Commission's regulations thereunder, except for the requirement of the existing small producer rule that they file an annual statement setting forth the total volume of their jurisdictional sales (R. 2-3).

In justification for its proposed action the Commission suggested that the relief previously granted under the existing Small Producers Certificate program "has been inadequate for small producers since they still bear many of the expenses and burdens of complying with regulatory requirements, particularly when they seek the same treatment accorded large producers. Such relief has also increased the difficulties inherent in processing small producer filings from an administrative viewpoint instead of decreasing these problems as was intended." (R. 2) In addition, the Commission stated that exempting small producers from compliance with the Natural Gas Act should encourage them to increase their exploratory efforts. The Commission suggested that the impact of the proposed exemption on consumers should be "minimal" since small producers account for a relatively small share of the gas produced nationally and are not normally in a position to obtain more for their gas than the large producers whose sales are subject to the just and reasonable area rate ceilings (R. 2).

No attempt was made in the Notice at a legal justification for the Commission's action, other than a general reference to Justice Clark's suggestion in the *Hunt* case, *supra*, that the Commission consider the availability of exemption procedures (see R. 2-3).

Following the receipt of comments, many of which opposed the exemption proposal or recommended substantial modification thereof, and the holding of an informal conference between the members of the Commission staff and all interested parties, in which many of the objections expressed in the written comments were further detailed, the Commission on March 18, 1971, issued its Order 428 in the proceeding (Pet. App. 29a). While this order was denominated as an "Order Establishing Blanket Certificate Procedure for Small Producer Sales and Providing Relief From Detailed Filing Requirements" it did

nothing significant in either respect which had not been accomplished in the Small Producer Certificate procedure established by Order 308 over five years earlier. Instead, the new Order, while no longer purporting to exempt small producers from all rate regulation under the Natural Gas Act, in effect achieved this objective. It did so by relieving the small producer of all necessity for complying with the just and reasonable area rate ceilings which had been adopted for the various production areas or any other maximum price limitations.

This action, the Commission stated, did "not constitute deregulation of sales by small producers" (Pet. App. 32a), since it would "continue to regulate such sales at the pipeline level by reviewing the purchased gas costs of each pipeline with respect to small producer sales." But the "consumer protection" to be afforded by such review was promptly vitiated by the assurances the Commission gave to the pipeline, and the large producer purchasers of gas from small producers, that they would be permitted to pass on to their customers *all* higher prices they might pay small producers for gas as long as the rate was not "unreasonably high considering appropriate comparisons with *highest contract* prices for sales by large producers or the prevailing market price for *intrastate* sales in the same production area" (Pet. App. 35a, 37a, emphasis added).

The Commission's justification for its action is sparse, and limited to summary statements of objective. It confines its legal analysis of its action to a bare denial of the claim that the provisions of Section 4, 5 and 7 of the Act are "mandatory and leave no room for administrative judgment and discretion," and a reference to the Supreme Court's language in the *Permian Basin Area Rate Cases*, noted above, relating to the Commission's classification powers under Section 16 (Pet. App. 31a). On the merits, the Commission no longer concludes that

the impact of its action, which it found will affect over 10% of the gas purchased by pipelines from producers and an unspecified additional amount of gas purchased by large producers for resale to pipelines (Pet. App. 37a), is *de minimus*. But it repeats the statements from its Notice that its action will ease the administrative burdens on the small producers and in its processing of small producer filings (*ibid.*). And it concludes, in general terms, that its actions, though not intended to increase contract prices, should encourage small producers exploratory efforts and facilitate the entry of the small producer to the interstate market (*ibid.*). Nothing whatsoever is stated in the Commission's Order as to why the removal of all price ceilings from flowing gas already committed to the interstate market by the small producer will result in any public benefit.

New York filed, on April 19, 1971, a petition for rehearing of Order No. 428 (R. 410). Numerous other parties also filed petitions for rehearing. In Order 428-B, issued July 15, 1971, the Commission, with minor exceptions not here relevant, denied the applications for rehearing (Pet. App. 50a).

The Court of Appeals for the District of Columbia Circuit (Judges Wilkey and Robinson, with Judge Fahy dissenting) reversed (Pet. App. 1a-22a). It did not dispute the Commission's right to classify small producers separately for rate making purposes, or to provide different or higher rates for such producers upon a record providing a factual predicate therefor. But it concluded that the Commission's rule, in freeing small producers from all direct price restrictions and tying the indirect regulation through control over the purchaser to sales at prices above the *highest contract price* for a contemporaneous sale by a large producer in the area or the prevailing market price for the unregulated intrastate sales, had failed to meet the just and reasonable standards established by

Section 4 of the Act for all sales in interstate commerce for resale. In so holding, the Court expressly rejected the contention that "while the Commission would no longer be regulating rates, the *market mechanism* itself would, in effect, dictate small producer prices which were 'just and reasonable.'" (Pet. App. 13a, emphasis in original). The Court held that this *post hac* rationalization not only ignored the essential difference between a regulated and unregulated industry, but was inconsistent with the Commission's orders which contained no conclusions that the market will necessarily yield rates which comply with Act's just and reasonable standard (Pet. App. 14a).

ARGUMENT

The Court below expressly affirmed the right of the Commission to classify small producers separately for substantive as well as procedural rate making purposes (Pet. App. 7a). It concluded, however, that the particular Commission action under review here, which completely removes small producers from any direct rate regulation under the Natural Gas Act and limits indirect regulation through the purchasers to circumstances in which the per Mcf sales price of the gas exceeded market norms, was impermissible under the standards of the Act.[3] Its decision is clearly correct and raises no question calling for this Court's plenary review.

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[3] The "Question Presented" in No. 72-1490 (FPC Pet. 2) suggests, *inter alia*, that questions are presented as to the authority of the Federal Power Commission "to exempt small producers from certain filing requirements under the Natural Gas Act." See also FPC Pet. 10. But nothing in the lower court's opinion in any way deprives the Commission of the right to exempt the small producer from any filing requirements of the Act, as distinguished from the substantive requirements of Sections 4 and 5 that all producers rates be just and reasonable. Specifically, nothing in the lower court's opinion in any way suggests that the blanket "small producer certificates" established by Commission Order No. 308 in 1965 (see *supra*, p. 4), was not a proper exercise of the Commission's authority.

1. The Commission's orders remove all regulatory limits on the rate a small producer may charge for sales made in interstate commerce for resale, with respect to both new sales and flowing gas. The entire regulatory control allegedly asserted is an indirect one imposed upon the purchaser in terms of the circumstances in which the latter will be permitted to pass on higher rates resulting from small producer sales to their customers. Even in a situation where the purchaser is not permitted to do so, the small producer is not affected, and may continue to collect the higher rate.

It is true that these rates will, as a matter of law, remain subject to *prospective* revision under Section 5(a) of the Act, despite the Commission's attempt to assure the small producers to the contrary (Pet. App. p. 31a). But this Court has long since made clear that the residual power of the Commission under Section 5 is not a permissible substitute for authorizing sales to be made at rates above the just and reasonable level. *Atlantic Refining Company* v. *Public Service Commission*, 360 U.S. 378. And the reference in the petition for certiorari (p. 12) to the Commission's statement that it would take "further action" to protect consumers if its program turned out to be inimical to their interests, is equally without significance since the only alternative action to a prospective Section 5(a) proceeding would be the *prospective* termination of the rules it here adopted.

We agree with the court below (Pet. App. 7a, 10a and n. 17) that there is considerable question whether such indirect regulation of sales through the exercise of control over the eventual purchaser is lawful under the standards of the Act, which in terms are applicable to "all rates and charges . . . by *any* natural gas company (Natural Gas Act, Section 4). But, we also agree with the Court of Appeals that it is unnecessary to resolve this question since, even if indirect regulation could be

justified in other circumstances, the standards established for such indirect regulation by the present rule are patently unlawful. For the Commission held that the price for gas in small producer sales will not be challenged as "unreasonably high" in considering the right of the purchasers to pass the costs to their customers, as long as they are consistent with the "*highest* contract prices for sales by large producers or the prevailing market price for *intrastate* sales in the same producing area" (Pet. App. 35a, 37a). As the Commission's petition for certiorari frankly admits (pp. 12-14), this merely equates the just and reasonable standards of the Act with the unregulated "market mechanism." The intrastate market is not regulated at all, and large producer contract prices, to say nothing of the highest such price, have traditionally been established at rates substantially higher than the Commission has prescribed as the just and reasonable ceilings in the hopes of subsequent deregulation or regulatory changes.

The Commission's attempt to portray the lower court's decision as being in conflict with this Court's decision in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 795 is spurious. The Court in *Permian* did not hold that the Commission could lawfully equate market prices with the just and reasonable rates mandated by the Natural Gas Act, but merely stated it was not there pretermitting such a conclusion in the event the Commission in subsequent area rate proceedings "clearly established"—contrary to the findings the Court expressly upheld in *Permian*—that the market mechanism will adequately protect consumer interests. There has been and could be no such determination in the present proceeding. The Commission made no investigation of the ability of either the interstate or intrastate market structure to protect the consuming public, and its orders contain no findings or even summary conclusions to this effect. On the con-

trary, in the various area rate decisions issued subsequent to its order here, where there was record evidence and arguments directed to the issue, the Commission has continually rejected the contention that it should or could set rates on the basis of "what-the-traffic-will-bear" *Southern Louisiana Area Rate Proceeding*, 46 FPC 86, 126 (1971), affirmed, *Placid Oil Company et al.* v. *Federal Power Commission*, C.A. 5, No. 71-2761, decided April 16, 1973. See also, *Texas Gulf Coast Area Rate Proceeding*, 45 FPC 674, petitions for review pending, *Public Service Commission et al.* v. *Federal Power Commission*, Case No. 71-1828, D.C. Cir.; *Other Southwest Area Rate Proceedings*, 46 FPC 900, petitions for review pending, *Shell Oil Company et al.* v. *Federal Power Commission*, Case No. 72-1114, 5th Cir.

The simple fact is that the Commission carefully refrained in any of its orders under review from finding that the rates the small producers could charge thereunder, or even those it provided the purchasers could pass on to their customers, were "just and reasonable". Instead, as the lower Court noted (Pet. App. 14a), the Commission's brief below expressly conceded that "[t]he Commission's order does not purport to determine the just and reasonable rates for sales by small producers." As far as rate regulation is concerned, the Commission merely concluded that the public interest in a time of gas shortage would best be served by removing all restrictions on this limited, but by no means *de minimus* part of the market.[3] This may arguably be a viable legislative position and the Administration is presently

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[3] While the Commission's original notice of rulemaking suggested the impact of its proposed rule would be *de minimus*, it admitted in Order 428 that it would affect 10.52% of all pipelines purchases, and that the impact on some pipelines would be twice as great (Pet. App. 32a). Moreover, the Commission made clear (*id.* at n. 1) that these figures did not include small producer sales to large producers for resale to the pipelines.

sponsoring legislation which would free all *new* producer sales from the Commission's regulatory authority.[4] But, at least on this record, it cannot conceivably be upheld as an appropriate application of the existing standards of the Natural Gas Act.

2. The Commission's petition for certiorari does not seriously contend that the opinion below would preclude it from taking such appropriate and lawful action, either with respect to small producers or producers as a whole, as might be required to increase gas supplies while at the same time protecting gas consumer producers from exploitation as a result of the existing supply-demand imbalance. Specifically, the Court's decision does not preclude the Commission from establishing separate and higher just and reasonable rate ceilings for small producers upon the basis of findings, resting on an adequate factual predicate (see *City of Chicago* v. *Federal Power Commission*, 458 F.2d 731 (D.C. Cir., 1971), *cert. den.*,

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[4] See President's Message on Energy, 119 Cong. Rec. (Daily Ed., April 18, 1973) pp. S 7692-98; letter of April 18, 1973 to the Speaker of the House from the Acting Secretary of the Interior submitting proposed bill "to amend the Natural Gas Act to the extent its application to the direct sales of natural gas in interstate commerce, and to provide that provisions of the Act shall not apply to certain sales in interstate commerce." 119 Cong. Rec. (Daily Ed., April 18, 1973) p. H 2976. The draft bill, subsequently introduced as H.R. 7507, provides that the provisions of the Act shall not apply to the sales of natural gas by an independent producer "dedicated for the first time to interstate commerce or rededicated upon the expiration of an existing contract on or after April 15, 1973, or produced from wells commenced on or after April 15, 1973. . . ."

The President's Energy Message made clear (*id.* at S 7693), that to protect consumers against "precipitous cost increases", and to avoid "generating windfall profits", the Administration was not advocating the general deregulation of the prices paid for flowing gas. However, as indicated, *supra*, Commission Order 428 would apply to all flowing gas production of small producers as well as to new sales thereby.

405 U.S. 1074 (1972), that their average costs[5] or some other factors so require. Nor does the Court's opinion in any respect freeze the Commission's rate determinations either with respect to small producers as a class or producers in general, into the regulatory framework the Commission adopted with this Court's approval in the *Permian Basin Area Rate Cases, supra.*

On the contrary, the Commission in the period since the issuance of its orders here, adopted or initiated a number of programs intended to increase the rates or revenues of gas producers, including small producers. See, *e.g., Accounting and Rate Treatment of Advance Payments,* Order No. 465, issued December 29, 1972, 38 F.R. 1385;[6] *Optional Procedure for Certificating Sales of Natural Gas in Interstate Commerce,* Order No. 455,

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[5] To the best of our knowledge, the only proceeding in which there was an effort made to determine whether small producer costs, on the average, were greater than those for producers generally was the *Permian Basin* proceeding, *supra.* The record data was, however, inconclusive and the Commission made no finding on the point, aside from concluding that an outright exemption of small producers, assuming it was legally permissible, was not "necessary or desirable" (34 FPC 159, at 234-235). The only findings the examiner could make in the light of the conflicting and incomplete data was that "on a per Mcf basis, the small producers had relatively larger dry hole expenses, a smaller proportion of geological and geophysical expenses, and a smaller proportion of lease acquisition expenditures. On a unit basis, smaller producers had a relatively larger DD&A expense than the larger producers" (34 FPC at 361).

[6] New York has filed a petition for review of this Order (*Public Service Commission* v. *Federal Power Commission,* No. 73-1338 (D.C. Cir.)) because of its belief that, particularly with respect to its application in off-shore areas in the Federal domain subject to the Commission's plenary jurisdiction, the Commission's order goes far beyond what has been justified by the record on which it relied. But the Commission's legal authority to adopt such a program to the extent it has a factual predicate for its action has been previously affirmed. See *Public Service Commission* v. *Federal Power Commission,* 467 F.2d 361 (D.C. Cir.).

issued August 3, 1972, appeals pending *Moss et al* v. *Federal Power Commission* (D.C. Cir., No. 72-1837); *Policy With Respect to Sales Where Reduced Pressures, Need for Reconditioning, Deeper Drilling or Other Factors Make Further Production Uneconomical at Existing Rates*, Order No. 481, issued April 12, 1973, 38 F.R. 9994; see also, *Just and Reasonable National Rates for Future Sales of Natural Gas from Wells Commenced on or After January 1, 1973*, Docket No. R-389-B, Notice of Proposed Rulemaking of April 11, 1973, 38 F.R. 10014. In short, while the possibility would in any event not justify action contrary to the standards of the Natural Gas Act, there is no basis for concluding that setting aside Order 428, as directed by the Court of Appeals, would significantly affect the Commission's power to take appropriate action with respect to the rates which can lawfully be charged by small producers.

CONCLUSION

The Court of Appeals' decision herein is clearly correct and the petitions for a writ of certiorari raise no questions regarding plenary review by this Court. It should, accordingly, be denied.

Respectfully submitted,

PETER H. SCHIFF
General Counsel
PUBLIC SERVICE COMMISSION
FOR THE STATE OF NEW YORK
44 Holland Avenue
Albany, New York 12208

RICHARD A. SOLOMON
WILNER & SCHEINER
2021 L Street, Northwest
Washington, D. C. 20036

Attorneys for Respondent

June 4, 1973